

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

Court copy with proof of service

BRADLEY R. BREWER

74-1069

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

Docket No. 74-1039

T-3087

GLEN-ARDEN COMMODITIES, INC.;
MILBANK TRADING CO., INC.;
ALBERT J. DEEB;
JOSEPH LAMONICA;
CHARLES LOFFMAN;
DAVID LOSEY;
PATRICIA GALIOTO; and
DAVID LOEB,

Appellants,

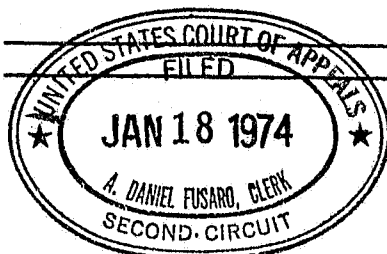
- against -

SECURITIES AND EXCHANGE COMMISSION,

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR
THE EASTERN DISTRICT OF NEW YORK

BRIEF OF APPELLANTS



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PROCEDURAL STATEMENT

This appeal was commenced when the appellants filed, simultaneously, on January 10, 1974, (1) timely notice of appeal in the district court below and (2) a petition, in the alternative, for issuance of either a writ of mandamus or an expedited appeal and prompt instructions to the court below to correct certain clear errors of law, abuses of discretion or actions in excess of jurisdiction which appellants maintain to have been committed by the district court below. The actions of the district court thus questioned included: (a) the issuance of four successive injunctive orders which have put appellants effectively out of business continuously since the first such order was issued on November 16, 1973; (b) the district court's failure to grant appellants' motion for prompt adjudication of their motion to dismiss for lack of jurisdiction and the SEC's related cross-motion for partial summary judgment and adjudication of those motions prior to the conduct of lengthy, protracted and costly evidentiary hearings on the SEC's motion for a preliminary injunction; (c) the district court's refusal to grant appellants certain pretrial discovery prior to the Rule 65 hearing; and (d) the district court's refusal to decide certain motions by appellants to strike affidavits filed by the SEC from the record. The petition also requested a stay of the injunctive orders below pending hearing and decision by this court of the issues therein presented.

By an undated order issued on January 11, 1974, this court (1) separated the petition into two different proceedings: a petition for mandamus and an appeal; (2) fixed an expedited briefing schedule for both to be completed by January 22, 1974; (3) set oral argument of both the petition and the appeal for January 23, 1974; and (4) denied the requested stay. By order dated January 16, 1974, this court granted appellants' motion to dispense with filing a joint brief, to proceed with the appeal on the original record below, and for permission for both parties to file four copies of typewritten briefs.

QUESTIONS PRESENTED

(1) Did issuance by the court below of the series of injunctive orders here involved or of the last such order represent (a) a non-appealable temporary restraining order subject to review by this court only on application for a writ of mandamus or (b) a preliminary or interlocutory injunction issued in open court, not ex parte, and subject to review by this court on appeal pursuant to 28 U.S.C. § 1292(a)(1)?

(2) Did issuance by the court below of the series of injunctive orders below, together with oral orders issued from the bench continuing certain of them in effect, or issuance of the last such order, which have had the effect of putting the appellant corporations completely out of business and of depriving the individual appellants of their livelihoods continuously since November 16, 1973, (a period of more than nine weeks), constitute or involve (a) a clear violation of controlling principles of law and equity, or (b) arbitrary, unjustified or unreasonable action by the respondent, or (c) abuse of the discretion of the court below under the Federal Rules of Civil Procedure, requiring this court to vacate the injunctive orders below (or direct that they be vacated forthwith and that this court's mandate issue forthwith) and direct the lower court on remand to issue no further or similar interlocutory orders or injunctions in this action?

(3) Was it serious error or an abuse of discretion

for the court below to conduct, over appellants' vigorous objections, a protracted evidentiary hearing of nine days' duration devoted almost exclusively to issues of alleged fraud, when the issue of fraud was irrelevant either for purposes of determination of the main issue, jurisdiction, or for purposes of issuance or denial by the court below of the injunctive relief requested by the plaintiff government agency?

(4) Does the district court have jurisdiction of this action under Section 22(a) of the Securities Act?

(A) Does this action, as a matter of law, involve an "offense" or "violation" under the Securities Act within the meaning of Section 22(a) thereof; or is this action a "suit in equity ... [or] an action at law brought to enforce ... [a] liability or duty" created by the Securities Act within the meaning of Section 22(a)?

(B) Did Congress, by legislative act, expressly (i) deprive the SEC of authority to regulate or to commence action under Section 20(b) of the Securities Act with respect to sales, such as those at issue in this proceeding, involving title "of record" to specific, identified casks of Scotch whisky in storage under government supervised bond in Scotland

and (ii) deprive the federal district courts of jurisdiction under Section 22(a) of that Act over any such action by the SEC when, in 1934, the definition of the term "security" set forth in Section 2(1) of that Act was amended and a specific reference previously incorporated in that definition to "certificate[s] of interest in property, tangible or intangible" was deleted and the scope of the regulatory authority set forth in Section 20(b) and the judicial jurisdiction set forth in Section 22(a) was correspondingly narrowed or restricted?

(5) If the answer to Question (4) is "yes," does the Commission have statutory authority to bring this action under Section 20(b) of the Securities Act?

(A) Do the interests in Scotch whisky involved in this action constitute "investment contract[s]" within the meaning of that term in Section 2(1) of the Securities Act as interpreted by the Supreme Court in S.E.C. v. W. J. Howey Co., 328 U.S. 293, 298-299, 301 (1946)?

(B) Is the phrase "any interest or instrument commonly known as a security" included as part of the definition of the term "security"

set forth in Section 2(1) of the Securities Act void for vagueness under the Fifth Amendment and the holding in Dombrowski v. Pfister, 380 U.S. 479, 491 (1965)?

(6) If the answer to Question (5) is "yes," has the Commission presented to the district court sufficient hard, evidentiary facts to satisfy the threshold test of "probable cause" to commence suit set forth in Section 20(b) of the Securities Act?

(7) Does the district court lack subject matter jurisdiction of this action?

(8) Has the Commission failed to state a claim upon which the interlocutory and permanent injunctive relief requested in the complaint and in its motion under Rule 65, F.R.C.P., can be granted?

(A) Can either a preliminary or a permanent injunction properly be issued to enjoin conduct (i) which is not clearly prohibited or made unlawful in language capable of being understood by a reasonable layman by any law or administrative regulation or order and (ii) as to which no reasonably clear notice or warning of the alleged illegality of the conduct sought to be enjoined has been given to the corporate and individual appellants against whom an

injunction is sought to be issued?

- (B) Where (i) there has been no statute enacted and no administrative regulation or order issued clearly stating in reasonable terms the unlawful character of conduct sought to be enjoined by a federal regulatory agency and (ii) such conduct by the appellants involves the operation of substantial businesses by the corporate appellants and the personal livelihoods of the individual appellants named in the action, would issuance by the court of either a preliminary or a permanent injunction the effect of which would be to destroy the businesses and the livelihoods of the appellants constitute either (a) a gross violation of general principles of equity or (b) a violation of the appellants' rights under the Fifth Amendment to the United States Constitution not to be deprived of property by government action except pursuant to due process of law? (See, S.E.C. v. Harwyn Industries Corp., 326 F. Supp. 943, 954, 955-958 (S.D.N.Y., 1971, Mansfield, J.).)

FACTS

The Complaint. On August 23, 1973, the Securities and Exchange Commission (the "SEC" or the "Commission") filed the complaint in this action. Soon thereafter service was made upon or admitted by some or all of the appellants including: Glen-Arden, Milbank, Deeb, Lamonica, and Galimoto. The complaint is set forth in three "causes of action" (alleging, respectively, violations of Sections 5(a) and 5(c) of the Securities Act [First Cause], Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act [Second Cause], and Sections 15(a) and 15(b) of the Exchange Act [Third Cause] and seeks both preliminary and permanent injunctions prohibiting the defendants, and others associated with them, in substance, from offering or selling or offering to purchase "securities in the form of scotch whisky warehouse receipts or any securities of any other issuer unless and until a registration statement has been filed with the Commission as to such securities [and] unless and until said defendants have registered as brokers and dealers with the Commission" and from engaging in any fraudulent conduct in connection with any such business activities.

The SEC's Motion for a Preliminary Injunction. Also on August 23, 1973, the SEC filed a motion under Rule 65, F.R.C.P., for a preliminary injunction supported by the affidavit of John J. O'Connor, an attorney on the staff of the Commission's New York Regional Office, and a lengthy memorandum of law. That motion was

made returnable on September 21, 1973; and the return date was later adjourned by the respondent to October 4, 1973, on defendants' motion brought on by order to show cause (signed and served on 9/18/73).

Defendants' Motion to Dismiss the Action for Lack of Jurisdiction. On October 4, 1973, defendants moved under Rules 12 and 56, F.R.C.P., for an order and summary judgment dismissing the action against all defendants for lack of subject matter jurisdiction and against certain defendants for failure to obtain personal jurisdiction. In support thereof, defendants submitted a 72-page memorandum of law and an affidavit of counsel admitting certain basic facts relevant to the issue of jurisdiction and denying other allegations made in the complaint and in the O'Connor affidavit. In their memorandum of law filed on October 4, 1973, defendants pointed out to the district court (a) that in a related subpoena-enforcement action involving one of the defendants in this action (Milbank), this Court (Second Circuit) had held that a serious question of law exists as to whether or not the SEC has jurisdiction to regulate, by commencing an injunction action under Section 5 of the Securities Act, the business activities of the present defendants, S.E.C. v. Brigadoon Scotch Distributing Co., 480 F. 2d 1047, 1052-1053 (2d Cir. 1973), and (b) that, where the jurisdiction of the district court is thus a substantial issue in the suit and one involving a great deal of doubt and the plaintiff seeks interlocutory injunctive relief, the court cannot, either reasonably or as a matter of law, (i) conclude that a strong

likelihood exists that a permanent injunction will ultimately be issued on the merits of the action or (ii) issue interlocutory injunctive relief, whether in the nature of a temporary restraining order or of a temporary injunction, under Rule 65, F.R.C.P. 601 West 26 Corp. v. Solitron Devices, Inc., 291 F. Supp. 882 (S.D.N.Y., 1968, Herlands, J.); National Hollow Brake Beam Co. v. Chicago Railway Equipment Co., 168 Fed. Rep. 666 (C.C.A. 7th 1909). See also, 7 Moore, Federal Practice (2d ed. 1973) ¶ 65.03 [3], at pp. 65-30 to 65-31, and ¶ 65.04 [1], citing inter alia, Hamilton Watch Co. v. Benrus Watch Co., 206 F. 2d 739, 742 (2d Cir. 1953); Checker Motors Corp. v. Chrysler Corp., 405 F. 2d 319 (2d Cir. 1969) cert. denied, 394 U.S. 999 (); National Assoc. of Letter Carriers v. Sombrotto, 449 F. 2d 915 (2d Cir. 1971); Ames v. Associated Musicians of Greater New York, Local 802, AFM, 251 F. Supp. 80 (S.D.N.Y., 1966, Levit, J.), aff'd, 359 F. 2d 777 (2d Cir. 1966); Carroll v. American Federation of Musicians, 310 F. 2d 325 (2d Cir. 1962); Carroll v. American Federation of Musicians, 295 F. 2d 484, 486 (2d Cir. 1961).

Plaintiff's Cross-Motion for Partial Summary Judgment.

Also on October 4, 1973, the SEC cross-moved under Rule 56, F.R.C.P., for partial summary judgment as to liability on its claim under Section 5 of the Securities Act (sale of securities to the public without an effective registration statement under the federal securities laws). The stated purpose of that motion was to join issue squarely on the question of regulatory and judicial jurisdiction by means of cross-motions for summary judgment under Federal

Rule 56 and, thereby, to facilitate a prompt ruling on that issue by the district court and a prompt appeal by the losing party to resolve the question by appellate determination. In support of that motion, the SEC submitted two affidavits of counsel, a statement of purportedly undisputed facts pursuant to General Rule 9(g) of the district Court, and 23-page memorandum of law.

Oral Argument Before the District Court on October 4, 1973, on Defendants' Jurisdictional Motion to Dismiss and Plaintiff's Motion for Summary Judgment under Section 5. On September 19, 1973, defendants had moved, by order to show cause, for hearing and determination of defendants' jurisdictional motion separate from and prior to conduct by the court of a lengthy evidentiary hearing under Rule 65, F.R.C.P., on the SEC's allegations of fraud under Section 17 of the Securities Act in support of its motion for a temporary restraining order. The rationale for that application was that a lengthy evidentiary hearing on the Commission's fraud allegations would be pointless and a waste of much time and effort by the court, the parties, potential witnesses, and counsel for both sides, since (as the SEC had pointed out in making its summary judgment motion) the case would be effectively resolved one way or the other by a ruling on the jurisdictional issue alone, and nothing would be added by holding lengthy evidentiary proceedings on complex and difficult factual questions of alleged fraud. If the district court should conclude and hold that the interests in Scotch whisky admittedly offered and sold by the defendants constitute "securities" within the

meaning of Section 2 (1) of the Securities Act, then the necessity for issuance of the temporary and permanent injunctive relief requested by the SEC would follow automatically, since concededly none of the defendants had obtained an effective registration statement or even applied for one. A prompt appeal by the defendants could be expected to follow promptly. On the other hand, if the district court should find for the defendants and find jurisdiction to be lacking, then the suit must be dismissed (regardless of whether or not fraud had been proved); and prompt appeal by the SEC would almost certainly result from a decision to that effect. In either case, proof and findings with respect to the alleged fraudulent conduct would be fundamentally irrelevant and meaningless.

During oral argument before the court on October 4, 1973, the court stated quite clearly that it would follow the proposal of counsel for the defendants and conduct a limited evidentiary hearing under Rule 12(d) or Rule 56, F.R.C.P., on the jurisdictional issue only, with the evidence clearly limited to facts bearing on the jurisdictional issue and the cross-motions for summary judgment only (as to which the basic facts were essentially agreed-upon between the parties) and proof on the issues of fraud expressly excluded. That oral argument was duly recorded by a court reporter, and a copy of the transcript was expressly requested at the time by counsel for the SEC and later by counsel for defendants. However, after a dispute arose later over what the court had stated at that time, the court reporter

expressed uncertainty as to whether or not he had recorded the argument, and he has failed to date to produce a copy of the transcript despite repeated requests by counsel for both sides for a copy thereof.

Also on October 4, 1973, the district court scheduled the proposed hearing (as thus expressly limited in scope) for November 15, 1973, and also scheduled a conference in chambers for October 31, 1973, at which the parties would report to the court on the progress then made on pre-hearing discovery in preparation for the evidentiary hearing scheduled for November 15, 1973.

Defendants' Motion Under Rules 56(e) and 65 F.R.C.P., to Strike Affidavits Submitted by the Commission and, Under Rules 34 and 26, for an Order Granting Reasonable Pretrial Discovery Prior to the Scheduled Evidentiary Hearing. On October 29, 1973, defendants moved (a) under Rules 56(e) and 65, F.R.C.P., for an order striking from the record before the court certain affidavits filed by the SEC on the ground that such affidavits were incomplete and inadequate as evidence as a matter of law and (b) under Rules 34 and 26, F.R.C.P., for an order granting defendants reasonable pretrial discovery prior to the hearing then scheduled to commence on November 15. Thereafter the respondent declined to rule on those motions, did not do so before the hearing which commenced on November 16, and has not done so to date.

The Conference in Chambers on October 31, 1973. At the conference in chambers on October 31, 1973, counsel for the SEC

changed its position as previously stated in support of its motion for summary judgment. Whereas the theory of that motion was that cross-motions for summary judgment would enable the court to get quickly and expeditiously to the heart of the case, which is the threshold question of subject matter jurisdiction, on October 31 counsel for the Commission took the position that the proposed evidentiary hearing scheduled to commence two weeks hence on November 15 should not be limited exclusively to factual issues related directly to the question of jurisdiction but, instead, should be expanded to include the issues of alleged fraud as well -- which would drastically expand the issues and necessary proof, and the length of the proposed hearing to include virtually the SEC's entire case on the merits of the action. In that connection, the SEC announced that it proposed to present at the hearing between 10 and 20 witnesses whose testimony could be expected to take at least ten full days of trial time. Counsel for the defendants objected vigorously, but the court announced that it would go along with the SEC's proposal and hear all of its proposed testimony at the hearing scheduled for November 15.

Thereafter, defendants' objections to the changed scope of the hearing and to the court's refusal to rule on defendants' motions of October 29 and the plaintiff's response thereto were presented to the court in the form of letters dated November 2, November 5, and November 9, 1973.

First Temporary Restraining Order Issued on November 16, 1973. The evidentiary hearing commenced at approximately 3:15 p.m.

on November 16, 1973, and adjourned at approximately 5:15ⁿ p.m. before any significant testimony had been introduced by the SEC on either the issue of jurisdiction or that of the alleged frauds. Absolutely no testimony at all had been introduced involving defendants Milbank, Lamonica or Galioto.

Despite those facts and despite the vigorous objections of counsel for the defendants (a) that it would be improper as a matter of law to issue interlocutory relief with the court's jurisdiction remaining at issue and no ruling having been made on that issue by the court, (b) that it would be improper to grant the plaintiff the ultimate relief sought in the suit (termination of the business activities of the defendants) before any significant or substantial evidence had been introduced, (c) that stopping defendants' businesses completely would almost certainly moot the case by destroying the businesses completely before the hearing could even be completed, the court granted a motion by the SEC for the issuance of a temporary restraining order the effect of which was to completely paralyze defendants' business activities and put them effectively out of business. (Transcript of 11/16, pp. 56-66.)

Respondent executed a temporary restraining order on that day which, together with oral extensions issued from the bench and subsequent restraining orders executed on November 27, December 1, and December 18, have put defendants completely out of business for more than nine weeks and all but completely destroyed two substantial businesses without even a ruling from

the respondent on the question of the district court's subject matter jurisdiction or on the merits of the SEC's virtually non-existent and totally unproven fraud claims.

The Orders Below.

The orders below signed on November 16, November 23, December 1 and December 18 were all identical as submitted by the SEC to the court for execution, except that the latter three, unlike the first, expressly provides, on the last page, that effective service may be made by personal service or mail upon the defendants or their attorneys. The first order made no mention of service upon defendants' counsel.

As executed by the court, the order of November 16 was altered to be effective only until November 23, the next scheduled hearing date -- or for a period of eight days. All of the other orders were executed by the respondent as submitted and provide on their face that the injunctive effect of the order shall continue "pending determination of the plaintiff Commission's motion for injunctive relief." Thus despite the denomination "Temporary Restraining Order" appearing on the orders of November 23, December 1 and December 18, each of those orders and all of the orders taken together were in fact preliminary injunctions or one overall preliminary injunction the intended and actual effect of which was to enjoin defendants continuously from conducting their businesses from November 16, 1973, to the present.

None of the orders was consented-to by the defendants. Counsel for the defendants vigorously objected to all of them and, in so doing, referred, in the case of each order, expressly to written arguments incorporated in defendants' memorandum of law filed October 4, 1973, in which arguments had been made and

authorities cited to the effect that interlocutory injunctive relief could not and should not properly be issued in a case where the court's jurisdiction was an open and serious question of law, particularly in the absence of an express and reasoned adjudication by the district court on the jurisdictional issue and on the other equitable factors required by law to be considered in connection with and prior to issuance of a preliminary injunction. Despite those arguments, the district court below issued each of the orders appealed-from by simply executing the form of "temporary restraining order" presented to it by the SEC and without making any reasoned adjudication on the jurisdictional issue or articulating any conclusions as to what "good cause" the court felt had been shown for issuing the first order on November 16 or for reissuing or extending it on November 23, December 1 and December 18. Stating such conclusions on the record is expressly required by Rule 65(b), F.R.C.P.

The district court heard evidence presented by the SEC on nine different and widely separated dates over a period of more than 30 days: November 30, December 5, December 10, December 11, December 13, December 17, and December 18. Nearly all of the evidence presented was presented by the SEC and related to its allegations of fraud. Defendants' evidence took no more than two hours to present and consisted of the cross-examination of defendants Galioto and Deeb, both of whom were witnesses called and examined by the SEC.

ARGUMENT

POINT I

ISSUANCE BY THE COURT BELOW OF THE
SERIES OF INJUNCTIVE ORDERS HERE
COMPLAINED-OF OR OF THE LAST SUCH
ORDER CONSTITUTED THE GRANTING OF A
PRELIMINARY OR INTERLOCUTORY INJUNCTION
WHICH IS APPEALABLE BY THE DEFENDANT
APPELLANTS AS A MATTER OF RIGHT UNDER
28 U.S.C. Sec. 1292(a)(1).

28 U.S. Code, Section 1292(a)(1) provides, in pertinent part, that "the courts of appeals shall have jurisdiction of appeals from ... interlocutory orders of the district courts of the United States ... or of the judges thereof, granting [or] continuing ... or refusing to dissolve or modify injunctions" The instant orders clearly fall within that statutory language. For that reason, a notice of appeal was duly and timely filed herein.

"A properly drawn ex parte restraining order should state a time, not to exceed 10 days after entry, when it expires." 7 Moore, Federal Practice (2d ed 1973) 65.07, at p. 65-79. None of the series of injunctive orders here complained-of was issued ex parte, for all were applied-for by the SEC in open court during hearings or oral argument on motions when counsel for the defendants was present. All of them, however, were applied-for, granted and executed without prior notice. Except for the first, issued on November 16, 1973 (which was expressly limited by the court to expire on November 23), none of those orders was limited by its

terms to a period of ten days or less. With the exception of that first order, each of the others, including the last, was by its express language made effective until issuance of a formal determination by the district court on plaintiff's motion under Rule 65, F.R.C.P., for a preliminary injunction.

Thus the series of orders here involved, taken together as a group, have had the effect, for all practical purposes, of enjoining completely and continuously the business activities of the two corporate appellants and the earning of the livelihoods of the individual appellants and their families for an indefinite period beginning on November 16, 1973, continuing for a period of more than seven weeks to the date of this appeal, and extending into the future for an indefinite period of time which will end only when the district court below eventually issues and enters a formal order determining the plaintiff's motion for a preliminary injunction. It is absolutely clear, therefore, that those orders viewed collectively and the last, in particular, represent or constitute issuance by the court below of a preliminary injunction as requested by the SEC (albeit without issuance of a formal decision on that motion) which is appealable as of right by appellants under 28 U.S.C. Section 1292 (a) (1).

"Unlike a preliminary injunction, which issues only after notice and hearing and is usually not subject to any fixed time limitation, a restraining order may be granted ex parte, but,

to prevent abuse, is subject [by Rule 65(b), F.R.C.P.] to a fixed time limit." 7 Moore, op. cit., 65.07 at p. 65-79. Appellants did not at any time consent to either the initial issuance of the orders in question or to any extension or reissuance thereof by the court below. Counsel for appellants at all times objected to the issuance, reissuance and continuation of those orders as unlawful, improper and a patent abuse of the discretion of the district court below.

It has been held "that no temporary restraining order may be continued beyond twenty days unless the party against whom the order is directed consents that it may be extended for a longer period." Sims v. Greene, 160 F. 2d 512, 516, (3d Cir. 1947). "[T]he statutory provision for an appeal to a court of appeals from an order granting an interlocutory injunction is not limited by the trial court's terminology, and when a restraining order, purporting to be "temporary" is continued for a substantial length of time past the period prescribed by Rule 65(b) and without compliance with its safeguards the "restraining" order is appealable as an interlocutory injunction." 7 Moore, op. cit., 65.07 at p. 65-83.

An injunctive order by a district court left open-ended and thus made effective over a period of many weeks without the consent of the parties enjoined and over their vigorous objection is, as a matter of law, a preliminary or interlocutory injunction appealable as of right under 28 U.S.C. Sec. 1292 (a)(1) despite

the fact that the order may have been labelled a "temporary restraining order" by the district court when it was issued. Morning Telegraph v. Powers, 450 F. 2d 97, 99 (2d Cir. 1971) ("The primary distinguishing characteristics of a temporary restraining order, under the Federal Rules, are its availability as an ex parte remedy, and its propensity to self-destruct after twenty days, at the outside. A preliminary injunction, on the other hand, has no such time limit, as it is by force of law granted only after both sides have been heard. The Union was heard on the propriety of preliminary relief in this case not once but three different times." Injunctive orders reversed, injunctive relief vacated, and the cause remanded.); Pan American World Airways v. Flight Eng. Intern. Assoc., 306 F. 2d 840, 841-843 (2d Cir. 1962) ("There is no statutory authority for the indefinite, successive extensions of temporary restraining orders." 306 F. 2d at 842, citing, U. S. v. United Mine Workers, 330 U.S. 258, 301 (1947). "The purpose of a temporary restraining order is to preserve an existing situation in statu quo until the court has an opportunity to pass upon the merits of the demand for a preliminary injunction. Such an order is necessarily limited to a very brief period because what may later prove to be a right of the party who is restrained is suspended before even a tentative adjudication as to that right has been had." 306 F. 2d at 842-843. "To deny review [under 28 U.S.C. § 1292(a)] of an order that has all the potential danger of a preliminary injunction in terms of

duration, because it is issued without a preliminary adjudication of the basic right involved, would completely defeat the purpose of this provision." 306 F. 2d at 843. Held: the instant order was appealable under 28 U.S.C. § 1292(a), cause remanded with instructions "to dissolve the injunction forthwith" and for the mandate to issue forthwith. Reason: the injunction had been issued without authority in the Railway Labor Act and, therefore, was in excess of the district court's jurisdiction.); accord, New York Telephone Co. v. Communication Workers of America, 445 F. 2d 39, 46 (2d Cir. 1971) (Injunctive orders reversed.).

POINT II

ISSUANCE BY THE COURT BELOW OF THE ORDERS
APPEALED-FROM CONSTITUTED OR INVOLVED

(1) A CLEAR VIOLATION OF CONTROLLING PRINCIPLES
OF LAW AND EQUITY UNDER RULE 65, F.R.C.P., OR
(2) ARBITRARY, UNJUSTIFIED OR UNREASONABLE
ACTION, OR (3) ABUSE OF THE COURT'S DISCRETION.

For the reasons stated and under the authorities cited in Point I above, it is a clear violation of controlling principles of law under Rule 65, F.R.C.P., and an abuse of discretion for a district court to issue four consecutive temporary restraining orders. If a temporary restraining order is extended or reissued for a period covering more than 10 days after original issuance, then Rule 65(b) plainly and expressly requires (a) that such action may be taken only "for good cause shown" and (b) that "the reasons for the extension shall be entered of record." Here no "good cause" was shown, no finding of "good cause" was made, and no meaningful reasons for extending or reissuing the order were "entered of record."

Similarly, the requirements set forth in Rule 65(b) for issuance of a preliminary injunction were clearly not followed by the district court. No formal motion was made for such relief and none was "set down for hearing at the earliest possible time" or thereafter decided by order of the court with reasons therefor stated of record.

The instant injunctive orders have, in effect, been in force continuously for a period of more than nine weeks and have had the effect during that time of paralyzing appellants' business

activities (which consist of buying and selling title interests to Scotch whisky stored in Scotland) and putting them completely out of business.

It is a well-established principle of both law and equity under Rule 65, F.R.C.P., that where the jurisdiction of the court is a substantial issue and the existence of such jurisdiction is, at best, an open question, the district court cannot properly issue interlocutory injunctive relief at the request of the plaintiff. 601 West 26 Corp. v. Solitron Devices, Inc., 291 F. Supp. 882 (S.D.N.Y., 1968, Herlands, J.); Ames v. Associated Musicians of Greater New York, Local 802, AFM, 251 F. Supp. 80 (S.D.N.Y., 1966, Levet, J.); Carroll v. American Federation of Musicians, 310 F. 2d 325 (2d Cir. 1962); Carroll v. American Federation of Musicians, 295 F. 2d 484, 486 (2d Cir. 1961); National Hollow Brake Beam Co. v. Chicago Railway Equipment Co., 168 Fed. Rep. 666 (C.C.A. 7th 1909). See also, National Association of Letter Carriers v. Sambrotto, 449 F. 2d 915, 921 (2d Cir. 1971) ("It is, of course, true that a district court's denial of preliminary relief is usually subject to reversal only in the case of a clear abuse of discretion, but this presupposes that the trial judge correctly understood and applied the pertinent law.")

In issuing the injunctive orders below, the district court stated that its purpose in so doing was "to preserve the status quo." Defendants' counsel pointed out that in this case the "status quo" at commencement of the suit and up to the time, November 16, when the first order was requested by the SEC, was

that the defendants were in business and earning their livelihoods and that issuance of the requested injunctive relief would not preserve, but destroy the pre-existing status quo and, quite likely, the defendant corporations as well. But those arguments were summarily rejected by the district judge, who then proceeded to sign the order presented to him by the plaintiff. That was patent error and a further clear violation of controlling principles of law and equity under Rule 65, F.R.C.P.

"[T]he traditional function of the preliminary injunction is to preserve the status quo, Checker Motors Corp. v. Chrysler Corp., 405 F. 2d 319, 323 (2d Cir.), cert. denied, 394 U.S. 999 (1969), and, as a general rule, the status quo is the last uncontested status which preceded the pending controversy, Westinghouse Elec. Corp. v. Free Sewing Machine Co., 256 F. 2d 806, 808 (7 Cir. 1958)." National Assoc. of Letter Carriers v. Sambrotto, 449 F. 2d 915 at 921 (2d Cir. 1971).

In the present case, the status quo ante was obviously one in which appellants were in business and not shut down completely, and it is equally obvious that, contrary to the stated reasoning of the district court below, issuance of the injunctive relief requested by the SEC did not preserve, but instead destroyed the prior status quo. That rationale was stated by the court sua sponte. See, 7. Moore, Federal Practice (2d ed. 1973) 65.03[3] and 65.04[1], citing, inter alia, Sambrotto, supra; Checker Motors Corp., supra; and Hamilton Watch Co. v. Benrus Watch Co., 206 F. 2d 739, 742 (2d Cir. 1953).

At no time did the district judge below either state that he had decided the jurisdictional issue or that he found it to be free from the substantial doubt which this court had previously found it to possess in the closely-related Brigadoon case, supra, 480 F. 2d 1047, 1052-1053 (2d Cir. 1973). Indeed, in view of this court's statement in Brigadoon it would appear to rest with this court to resolve that issue and to be beyond the authority of the court below to remove that issue from its present state of irresolution in this circuit.

Another reason indicated by the court below for issuing the instant orders was the district court's stated desire to "facilitate" and hasten the progress of the hearing by placing the defendants under the pain, duress, inconvenience and financial stress of being enjoined from engaging in the conduct of their businesses during the course of the hearing and thus providing them with motivation to persuade their counsel to make fewer objections than he otherwise might and do everything possible to hasten completion of the hearing.

The court stated "I am only interested in proceeding with this case. And this appears to be the way to facilitate it." (Transcript of 11/16, p. 62.)

The intended meaning of those words as stated above was clearly conveyed to counsel for both sides. The understanding of counsel for the SEC is clearly shown at page 248 of the transcript of November 23, where SEC counsel stated:

"I think there is a compelling need to have the temporary restraining order so that

the trial will move along as quickly as it did today.

"I would remind the Court -- I think the Court originally made this observation -- things will move faster where the temporary restraining order is in effect. I think they did move faster today and in so moving I think we exhibited there was clear reliance by these investor witnesses on what was represented to them by the defendant. I just do not think there will be any question. I won't belabor the point."

(See, in that connection, the colloquy at pp. 246-255 of the transcript of 11/23.)

When the first injunctive order below was issued on November 16, 1973, hardly any testimony at all had been introduced by the plaintiff and absolutely no evidence whatever had been introduced with respect to defendants Milbank, Lamonica or Galioto. Moreover, no evidence at all bearing upon the latter three defendants was introduced until December 13, 1973, at the earliest. However, despite such complete lack of significant evidence, the injunction below was issued indiscriminately against all of the defendants without regard to the minimal evidence then before the court.

The fact that the injunctive relief here in question was issued at the very commencement of the nine-day hearing below and before any significant evidence had been introduced provides a further clear indication that the injunction was issued arbitrarily and unreasonably simply because the plaintiff Commission had requested it and without any significant consideration having been given or any determination having been made by the court below

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as to (i) the balance of equities involved in the circumstances, or (ii) the severe and irreparable (indeed probably fatal) damage likely to be caused to the businesses of the corporate defendants, or (iii) the likelihood of the SEC's ultimately prevailing on the issue of jurisdiction, or (iv) the likelihood of the SEC's ultimately prevailing on the merits of the action.

As a consequence, it is quite evident that issuance of the injunctive relief below was arbitrary, unreasonable, contrary to controlling principles of law and equity, and an abuse of the discretion of the court below. For that reason, either a writ of mandamus or appropriate instructions on remand should be issued by this court to correct the severe and extremely damaging error committed by the district court.

As this court has quite correctly stated in the context of what is now 28 U.S.C. § 1292(a) (quoting from Chief Judge Magruder in In re Josephson, 218 F. 2d 174, 182 (1st Cir. 1954): "'Abuse of discretion' is a phrase which sounds worse than it really is. All that it need mean is that, when judicial action is taken in a discretionary matter, such action cannot be set aside by a reviewing court unless it has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." Carroll v. American Fed. of Musicians of U.S. & Canada, 295 F. 2d 484, 488-489 (2d Cir. 1961), citing also, Judge Learned Hand in Barnet v. Equitable Trust Co., 34 F. 2d 916, 920 (2d Cir.

1929); and Ring v. Spina, 148 F. 2d 647 (2d Cir. 1945).

We respectfully submit that, on the present record, there is more than an ample and persuasive basis for this court to form a definite and firm conviction (1) that the court below committed a clear error of judgment in issuing the orders appealed-from and (2) that the court below also based its ruling on a clear error or misunderstanding of applicable principles of law and equity under Federal Rule 65.

In a motion previously filed in this appeal, appellants asked this court, and they request again here, that this court (a) vacate the injunctive orders below as promptly as possible and (b) issue instructions on remand to the court below directing that court not to issue any further interlocutory injunctive orders against appellants in this action. Of course such instructions, if issued, would not preclude the district court from issuing such form of final judgment as it may deem appropriate at the conclusion of the proceedings below. Appellants respectfully submit that vacation of the orders below is both necessary and appropriate in this case (1) to prevent mootness of the case and granting the SEC the ultimate relief it seeks herein by destroying the businesses of the defendant corporations and thus putting them permanently out of business before a decision on the merits is rendered by the court below (see transcript, pp. 56-66, 246-255 and 364-371), (2) because of the serious and debatable character of the jurisdictional issue in this case, and (3) because there has been a complete failure by the district

court, in issuing those orders, to comply with the express requirements of Rules 65 and 52, F.R.C.P., with respect to issuance of preliminary injunctions. Packard Instrument Company v. ANS, Inc., 416 F. 2d 943, 945 (2d Cir. 1969); Saxe v. U. S., 471 F. 2d 1293, 1296 (2d Cir. 1972).

POINT III

IT WAS PALPABLE ERROR AND AN ABUSE OF DISCRETION FOR THE COURT BELOW TO CONDUCT, OVER APPELLANTS' OBJECTIONS, A PROTRACTED EVIDENTIARY HEARING OF NINE DAYS' DURATION DEVOTED ALMOST EXCLUSIVELY TO ISSUES OF FRAUD ALLEGED BY THE SEC, BECAUSE A DETERMINATION AS TO FRAUD WAS COMPLETELY UNNECESSARY IN ORDER FOR THE SEC TO OBTAIN THE INJUNCTIVE RELIEF REQUESTED BY IT IF IT SHOULD PREVAIL ON THE QUESTION OF JURISDICTION.

It is self-evident in this action by the SEC that ultimate victory by it on the issue of its regulatory jurisdiction over the appellants' business activities and on the identical issue of the court's subject-matter jurisdiction over this action will result in issuance of the injunctive relief it has requested -- regardless of whether or not fraud by the appellants is ever proved. Both of those jurisdictional issues turn upon whether or not the interests in Scotch whisky sold by the appellants constitute a "security" within the meaning of Section 2(i) of the Securities Act. If they are ultimately held to be "securities," then both a finding of violations of Section 5 of that Act and the requested injunction must follow automatically, since neither of the appellant corporations has ever filed an application for a securities registration with the SEC. If they are held not to be "securities," then the suit must be dismissed no matter how many frauds the court might ultimately find to have been committed.

Consequently, it will be completely inconsequential for purposes of the ultimate relief granted in this action which side prevails on the SEC's completely irrelevant and redundant claims

and allegations of fraud. That circumstance was carefully explained to the court in motion papers submitted by the appellants on September 17, 1973, at the very beginning of this action. In those papers, appellants (i) explained the redundancy and irrelevance of the fraud issues and the pivotal character of the "security" issue as the key to both jurisdiction and the appropriateness of injunctive relief under Section 5 and (ii) requested that the court below limit its factual inquiry at the outset strictly to facts relevant to the issue of jurisdiction and, thereafter, rule promptly on that issue so that a prompt appeal would be possible and protracted evidentiary proceedings and the resulting expenditure of hundreds of hours of time (on the part of the court, counsel, the parties and witnesses) could be avoided, together with the expenditure of many thousands of unnecessary dollars by the appellants for counsel fees and hearing transcripts.

On October 4, 1973, the SEC accepted the practical soundness of that proposal by the defendants and, for the express purpose of joining issue immediately on the jurisdictional issue and facilitating a prompt ruling on it, made a cross-motion for partial summary judgment as to liability on the Commission's Section 5 claim. During oral argument on October 4 on both defendants' motion to dismiss and the SEC's summary judgment motion, the court appeared to perceive the coincidence of the procedural purposes of both parties and stated expressly that the hearing then set for November 15 would be limited to the issue of jurisdiction and facts directly related thereto.

As set forth above, some time between October 4 and October 31 (the date fixed on October 4 for a progress conference in chambers on discovery efforts) the SEC staff-attorneys in charge of the case abandoned the reasoning and procedural purpose behind their earlier Rule 56 motion and requested that the hearing on November 15 be expanded to include evidence on the Commission's fraud claims. In the latter connection, they stated that they expected to produce between 14 and 20 witnesses, among them as many as four "experts." At that point, the court below reversed its previous statement of October 4 (which had the effect of making the hearing a limited one under Rule 12(d) or Rule 56(d), F.R.C.P.) and transformed the proposed hearing scheduled for November 15 (two weeks hence) into a full-fledged evidentiary trial under Rule 65 likely to take ten days or more of trial instead of the one or two days that would have sufficed to establish the facts relevant to jurisdiction only.

At that point, the appellants were faced not with a brief hearing followed by a prompt appeal on tightly limited issues almost exclusively legal in character, but with a long and costly trial hearing under Rule 65 followed by a much more complex and costly appeal based upon a voluminous hearing transcript and involving a plethora of difficult, time-consuming, and completely irrelevant questions of fact and proof such as: (1) were certain alleged statements actually made by salesmen of the appellant corporations, and if made, were they statements of fact or opinion; (2) if statements of fact, were those statements untrue; (3) was

expert testimony from professional Scotch traders necessary to make a ruling on (1) and (2) possible; (4) if factual and untrue, did the salesmen who made them know them to be untrue; (5) if factual, untrue, and known by the makers to be untrue, were those statements either authorized or ratified by the appellant corporations or otherwise legally attributable to them on any valid legal theory consistent with the proof presented; (6) assuming answers favorable to the SEC on (1) through (5) above, were those statements material, believed and relied-upon by actual customers; (7) if so, did any harm or significant pecuniary injury result to a sufficient number of customers to represent a significant harm to the "public interest" allegedly sought to be protected by the SEC when it began the action? Quite understandably, appellants' counsel objected most vigorously to that abrupt, drastic and pointless change in the procedural scenario.

Thereafter, the Rule 65 hearing began on November 16, and proceedings thereof were conducted on eight widely-separated dates thereafter covering a period of more than 30 days (11/23, 11/30, 12/5, 12/10, 12/11, 12/13, 12/17 and 12/18). After little more than one hour's testimony on November 16, the court below enjoined the appellants from doing any of their normal business activities. That injunction has been in effect continuously from November 16 to the present, and it is still in effect.

Appellants respectfully submit that it was pointless, unreasonable, severely and unnecessarily burdensome upon the defendants, and an abuse of discretion for the court below to make the

ruling it did on October 31 and, thereafter, to conduct a 10-day hearing over a 30-day period devoted almost exclusively to the receipt of massive amounts of testimony only vaguely connected to the SEC's fraud allegations -- all of which were themselves redundant.

POINT IV

THE COURT DOES NOT HAVE
JURISDICTION OF THIS ACTION
UNDER SECTION 22(a) OF THE
SECURITIES ACT.

- (A) This action does not, as a matter of law, involve any "offense" or "violation" under the Securities Act within the meaning of Section 22(a) thereof, nor is this action a "suit in equity...[or] an action at law brought to enforce any liability or duty" created by the Securities Act within the meaning of Section 22(a). Consequently, the district court does not have jurisdiction of this action under said Section 22(a).

Section 22(a) of the Securities Act provides, in pertinent part, as follows:

"Section 22. (a) The district courts of the United States, the United States courts of any Territory, and the United States District Court for the District of Columbia shall have jurisdiction of offenses and violations under this title and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this title."

It is evident from the text of Section 22(a) as quoted above that if the pleadings served and filed by the plaintiff

do not reasonably, properly, and as a matter of law, allege or involve any "offense" or "violation" of a substantive provision of the Securities Act (here a violation of either Section 5 or Section 17 thereof), then this court lacks jurisdiction over this action; and it must be dismissed in response to this motion by the defendants.

Therefore, the arguments presented as Point IV and Point V of this memorandum are linked together and turn upon the same basic and inter-related issues, i.e.:

(1) whether or not Congress, by legislative act, expressly deprived the SEC of authority to regulate or to commence action under Section 20(b) of the Securities Act with respect to sales, such as those involved in this action, involving title to specific, identified casks of Scotch whisky in storage under government bond in Scotland, when, in 1934, the definition of the term "security" set forth in Section 2(1) of the Securities Act was amended and a specific reference previously incorporated in that definition to "certificate[s] of interest in property, tangible or intangible" was deleted and the scope of the regulatory jurisdiction set forth in Section 20 and the judicial jurisdiction set forth in Section 22 was correspondingly narrowed;

(2) whether or not the interests in (i.e., title to) specific casks of Scotch whisky in storage which the defendants sell (or have sold in the past) are "certificate[s] of interest in [tangible] property" within the meaning of the amendment to

Section 2(1) of the Securities Act effected by Congress in 1934;

(3) whether or not the amendment of Section 2(1) by Congress in 1934 described above effectively precludes the district court from interpreting either the term "investment contract" or the phrase "any interest or instrument commonly known as a 'security'" included in the definition of a "security" set forth in that Section to include anything which can properly and reasonably be characterized or described as included in the excised phrase "certificate of interest in [tangible] property";

(4) whether or not the interests in specific casks of stored Scotch whisky involved in this action and in the businesses conducted and the livelihoods earned by the defendants herein are "investment contracts" within the meaning of that term as included in the definition of "security" set forth in Section 2(1) and within the interpretation of that term set forth authoritatively by the Supreme Court in S.E.C. v. W.J. Howey Co., 328 U.S. 293, 301 (1946), where it held that an "investment contract" is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or third party" (emphasis supplied) and not at all from the efforts of the investor himself or through the operation of a third force entirely beyond the control of the seller, such as an open "commodities market"; and

(5) whether or not the interests (i.e., title to) specific casks of stored Scotch whisky involved in this action (a) are negotiable instruments properly characterized by the Commission as "warehouse receipts" (which defendants claim they are not, because the method they use to transfer title does not involve the use of any negotiable instrument) or (b) involve, as defendants maintain, simply the sale ("of record" only) of title to specific, identified casks of whisky resting in storage in Scotland under government supervised bond.

In this Point IV, we will discuss only the related statutory interpretation issues listed as (1), (2) and (3) in the preceding paragraph and leave for discussion in Point II the issues listed as (4) and (5).

(B) Congress, by legislative act, expressly deprived the SEC of authority to regulate or to commence action under Section 20(b) of the Securities Act with respect to sales, such as those at issue in this proceeding, involving title "of record" to specific, identified casks of Scotch whisky in storage under government supervised bond in Scotland when, in 1934, the definition of the term "security" set forth in Section 2(1) of that Act was amended and a specific reference previously incorporated in that definition to "certificate[s] of interest in property, tangible or intangible" was deleted and the scope of the regulatory authority set forth in Section 20 and the judicial jurisdiction set forth in Section 22 was correspondingly narrowed.

Chapter 3, in Volume I of Professor Louis Loss's

authoritative treatise aptly entitled Securities Regulation, is entitled: "Coverage of the Securities Act of 1933: Definitions and Exemptions." Section A of that chapter is headed "Definitions." The first one and one-half pages of that section are highly relevant to the proposition set forth as Point (B) above, and for that reason they are reproduced exactly on the following page of this brief.

1. "SECURITY," "PERSON" AND "ISSUER" [§§2(1),
2(2), 2(4)]

Thus far we have been using terms like "security" and "issuer" as if there were no doubt about their meaning. In most cases that is so. When §2(1) of the 1933 act defines "security" to mean "any note, stock, treasury stock, bond, [or] debenture" and §2(4) says that the "issuer" is "every person who issues or proposes to issue any security," the meaning is perfectly obvious. The problems are created by various special types of legitimate financing,¹ and by the fringe operators who would treat any definition of "security" in orthodox terms as an invitation to evade the statute by employing other kinds of instruments. So, taking advantage of the states' experience with their blue sky laws, Congress defined the word "in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security."²

As amended in 1934, the term "security" is now defined to mean

any note,³ stock, treasury stock, bond, debenture, evidence of indebtedness,⁴ certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.⁵

Since §2(1) was modeled on the definitions in some of the state blue sky laws and in turn influenced many of the new state statutes enacted since 1933,⁶ state and federal cases are to some extent interchangeable in this area. But caution must be used for two reasons. Often there are slight but potentially significant variations in the wording of the particular phrase of the definition relied upon. And a case may also be distinguishable because of the presence of some other and broader phrase in the particular statute than that which is common between the two cases.

¹ Even such terms as "stock" and "bond" do not have altogether fixed meanings. And there are the hybrid instruments which seem to be securities all right but which defy classification. See Hansen, *Hybrid Securities: A Study of Securities Which Combine Characteristics of Both Stocks and Bonds*, 13 N. Y. U. L. Q. Rev. 407 (1936); Comment, *Status of Holders of Hybrid Securities: Stockholders or Creditors?* 45 Yale L. J. 907 (1936). For the usual classifications of securities offered to the public, see Dice and Eiteman, *The Stock Market* (3d ed. 1952) c. 2; 1 Dewing, *The Financial Policy of Corporations* (5th ed. 1953) part I. For a critique of the usual classification, see Graham and Dodd, *Security Analysis* (3d ed. 1951) c. 8.

² H. R. Rep. No. 85, 73d Cong., 1st Sess. (1933) 11.

³ Whether the issuance of a note or other evidence of indebtedness involves a "sale" of a "security" is considered *infra* page 546 in connection with the definition of "sale."

⁴ *Ibid.*

⁵ §2(1). In its original form the section included also, as some state statutes do, any "certificate of interest in property, tangible or intangible." This phrase was removed in the 1934 amendments as perhaps involving "too broad and uncertain application." H. R. Rep. No. 1333, 73d Cong., 2d Sess. (1934) 39. In its place were inserted "certificate of deposit for a security" and "fractional undivided interest in oil, gas, or other mineral rights." The only other changes were the insertion of the words "interest or" and "guarantee of" in the clause beginning "in general." See *app. D infra*.

⁶ The definition in §401(l) of the Uniform Securities Act is identical except for oil, gas and mineral interests and the addition of a sentence on variable annuities. See Loss and Cowett, *Blue Sky Law* (1958) 3.

The pertinent full paragraph from page 39 of the House of Representatives Report, No. 1838 (May 31, 1934) (Conference Report to accompany H.R. 9323), cited by Professor Loss in footnote 5 above is as follows:

"The amendment to section 2(1) of the act is to make clear, what is already a matter of interpretation, that certificates of deposit, fractional oil royalty, or leasehold interests and interests of a similar character are included within the definition of a security and thus subject to the Securities Act. It is also intended to apply the act to interests commonly known as "securities" whether or not such interests are represented by any document or not.[sic] Thus the statute will apply to inscribed shares, and its provisions cannot be evaded by simply refraining from issuing to the subscriber any documentary evidence of his interest. The phrase 'certificate of interest in property, tangible or intangible' is stricken out as possibly involving too broad and uncertain application. In conference it was agreed to include guarantees specifically. Their inclusion in section 2(1) and the omission of specific mention of guarantors in section 2(4), as proposed by these amendments will make it clear that guarantors are to be treated as issuers of securities only if the guarantees are incorporated in securities distributed to investors. They will also indicate that the securities of which such guarantors are to be treated as issuers are the guarantees and do not include the securities guaranteed. The result is properly to limit their responsibility under section 11 to the registration statement filed as to the guarantee."

We submit that it is apparent from the foregoing legislative history of Section 2(1) of the Securities Act that,

one year after that section was enacted in 1933, Congress took another long look at what it had wrought and decided, in its wisdom, that it had writ too broadly when it wrote the original definition of "security" set forth in Section 2(1). And it decided to narrow that definition by removing therefrom the words "certificates of interest in property, tangible or intangible," which the SEC had written into the statute as originally submitted to Congress for consideration, and inserting, in place of them, the words "certificate of deposit for a security" and "fractional undivided interest in oil, gas, or other mineral rights."

We submit, further, that it is equally apparent that the Commission would be much better off, in this proceeding, if Section 2(1) had today the same text it had, briefly, between 1933 and 1934, because the wares sold by the defendants in this case would seem clearly to be "certificates of interest in [tangible] property," and the present text of that section rather clearly does not, by its express language or by any readily evident inference therefrom, include either negotiable "warehouse receipts" (such as are referred-to in the present complaint) or non-negotiable documents of title to specific, identified casks of bonded Scotch whisky in storage (such as those sold by the defendants).

Where Congress intended the term "security" as used in Section 2(1) to include something that might reasonably come within the excised phrase "certificate of interest in [tangible] property," as in the case of "fractional undivided interest[s] in oil, gas or other mineral rights," it carefully included a specific reference in Section 2(1) to the "interests in property, tangible or intangible" which it wished to remain included in that definition. Fractional interests in "oil, gas or other mineral rights" are the only interests in specific property included by Congress in Section 2(1). Unless the court wishes to indulge in the entirely improper assumption that Congress was disoriented, irrational, stupid or otherwise did not know what it was doing when it drafted, enacted and then revised Section 2(1) of the Securities Act, then it must assume that the congressional effort disclosed in that section reflects a rational, coherent and discernible legislative purpose or intent. If that is so, then this court must give substantial weight in its analysis to the fact that Congress included in Section 2(1) only one, single reference to the sale of interests in specific property (i.e., oil, gas and other mineral rights) and clearly did not include any reference to sales of any other interests in specific property --- such as those involved in the sale of various "commodities" (which are commonly effected through the use of negotiable "warehouse receipts") and "commodity futures" (which are effected through the sale of

so-called "futures contracts"); including: wheat, soybeans, frozen orange juice concentrate, "pork bellies," cocoa, sugar, tobacco, cotton, and many other things.

Surely if Congress had intended to include within the coverage of the Securities Act sales of such specific items of property as oil paintings (which the SEC has strangely argued before this court to constitute "securities" under Section 2(1)) and ordinary automobiles (which Walter P. North, Acting General Counsel for the Commission told the Second Circuit during oral argument in the Brigadoon case might constitute "securities" in an appropriate case) or rare stamps, books, furniture, coins and manuscripts, then Section 2(1) would not have been drafted and revised as it was. There would be in it some general reference to sales of specific property such as the section originally contained; and the section would contain something more than a single, specific reference to the sale of undivided interests in certain mineral rights.

We submit that Congress clearly knew what it was doing and acted with considerable rationality, specificity and discrimination when it drafted, enacted and later revised Section 2(1). And it definitely did not intend, as the Commission now argues before this court, to give the SEC statutory authority to regulate sales of any kind of fungible "commodity," whether

it be wheat, soybeans or Scotch whisky stored in barrels somewhere in Scotland and aging in bonded warehouses.

It is quite clear, we submit, that the things sold* by the defendants in this action constitute "certificate[s] of interest in [tangible] property" within the meaning of that phrase which was excised or deleted by Congress from Section 2(1) when it was amended in 1934.

It is equally clear that the amendment of Section 2(1) by Congress in 1934 described above by Professor Loss effectively precludes this court from interpreting either the term "investment contract" or the phrase "any interest or instrument commonly known as a 'security'" included in the definition of "security" set forth in that section to include anything which can reasonably be characterized as included in the now deleted phrase "certificate of interest in [tangible] property" --- with the sole exception of "fractional undivided interest[s] in oil, gas or other mineral rights" specifically identified by Congress in the text of Section 2(1) itself. In order for this court to hold that it is not so precluded by the specific action of Congress described above, it would have to substitute

* Certificates representing title "of record" on the warehouseman's books to specific, designated casks of Scotch whisky in casks under bond in government supervised warehouses in Scotland, and not negotiable "warehouse receipts."

the opinion of the court or a power-seeking policy argument presented by the Commission for the carefully and specifically expressed will and intention of the Congress; and that, we submit, is something which this court not only should not do as a matter of reasonable and proper jurisprudence, but as a matter of law cannot do. The seriousness of this issue of statutory interpretation of Section 2(1) and the substantial character of Defendants' arguments in this connection were clearly indicated in the opinion by Circuit Judge Lumbard for the Second Circuit in the related Brigadoon case. See, S.E.C. v. Brigadoon Scotch Distributing Co., ____ F.2d ____ (2d Cir., 6/7/73), CCH, Fed.Sec.L.Rep., Curr. Vol., 194,017.

It is thus readily apparent that Congress itself undertook, in 1934, to change the language of Section 2(1) for the obvious and express purpose of removing from the language of the statute any reference, direct or indirect, to transactions involving the sale or transfer of "certificates of interest in property, tangible or intangible," i.e., documents of title to property such as warehouse receipts and other title documents covering commodities and other items of property.

What the Commission is attempting to do in this proceeding is to involve itself in precisely those areas of "too broad and uncertain application" of its regulatory powers under the Act which Congress has expressly acted to foreclose it from entering.

POINT V

THE COMMISSION DOES NOT HAVE
STATUTORY AUTHORITY TO BRING
THIS ACTION UNDER SECTION 20 (b)
OF THE SECURITIES ACT.

Appellants respectfully submit that the interests in specific casks of stored, bonded and insured Scotch whisky involved in this action cannot properly be construed by this court as "investment contracts" under Section 2(1) for a further reason in addition to the one based upon legislative history and congressional intent presented in Point I above, namely, that such interests in casks of Scotch whisky do not come within the authoritative judicial interpretation given by the Supreme Court in S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298-299, 301 (1946), to the term "investment contract" as used in Section 2(1).

In Howey, the Supreme Court held that an "investment contract" is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or third party" (emphasis supplied) and not at all from the efforts of the investor himself or through the operation of a third force entirely beyond the control of the seller, such as an open "commodities market."

Howey was an "orange grove" case, in which the seller sold to members of the public, as "investments," two things:

(a) a specific and identified parcel of real property constituting a limited portion of a larger "orange grove" managed and "farmed" by the seller and its associates and (b) a "management contract" or "service agreement" under which the seller assumed an obligation to "farm" or "manage" the investor's orange grove parcel for him. The Supreme Court simply held:

(1) that the two purportedly separate transactions must be viewed as, in reality, two halves of a single investment transaction; (2) that what the buyer actually purchased from the seller was a "share" or "participation" in the overall orange grove operation run by the seller and its associates; and (3) that, consequently, the thing purchased by the buyer was not materially distinguishable from the purchase of a share of the communications operation conducted by AT&T --- the common denominator between the two situations being that in the case of an orange grove participation investment, as in the purchase of a share of AT&T common stock, the value of the thing purchased at the time when the buyer comes to resell it will depend upon how well (or how badly) "corporate management" has operated or conducted the business, i.e., how well the "common enterprise" in which the investor purchased a "share" or participation in profits has been "managed" by the operators of the business.

That holding in Howey makes very good, practical sense; and we submit that it is both sound securities law and a controlling precedent in which a rule of law was established that governs this case. The reasoning of the Supreme Court described above makes quite clear, we submit, why the Supreme Court held in Howey that the term "investment contract" is, in reality and as a matter of federal law under Section 2(1) of the Securities Act, simply another term for a "share" or "participation" in a "common enterprise" in which the value of the thing purchased (i.e., whether the buyer makes a profit or takes a loss on his investment) depends "solely" and exclusively upon the management efforts put forth by the seller or a third party associate of the seller.

Use of the word "solely" by the Supreme Court in Howey is very important. We submit that that word was used very carefully and purposefully in the opinion as a specific limitation upon the meaning of the term "investment contract." Why? For the simple and obvious reason that all purchases for investment purposes by members of the public do not involve the sale of "securities" which Congress intended to have the SEC regulate when it enacted the Securities Act in 1933 and amended it in 1934. And that is true no matter how vehemently, energetically and sincerely attorneys on the staff of the SEC may argue to the contrary.

If a man buys a carload of cotton bales or a warehouse full of cigarette tobacco or fifty tons of granulated

sugar or a crop of unharvested corn or potatoes as an "investment" and for purposes of "speculation," he obviously has not purchased a "security" as defined in Section 2(1) of the Securities Act, and the sale need not be made pursuant to a registration filed with the SEC. And that is true regardless of how many such sales the seller has made in the past, regardless of whether he makes representations as to the value of the thing sold, regardless of whether he has obtained casualty and/or "title insurance" to the goods and has offered to transfer the insurance coverage to the buyer, regardless of whether or not the seller represents himself to be an "expert" in the cotton or tobacco business, regardless of whether or not the buyer relied upon such purported "expertise," and regardless of whether or not the seller either promises or leads the buyer to believe that the seller will help him resell the goods if and when the buyer wishes to resell them. Why is that so? It is so because the value of the goods purchased at the time of resale by the buyer will not depend "solely" upon "management" efforts put forth by the seller or some third party between the date of purchase by the buyer and the date of resale by him. In fact, the value at resale will not depend at all upon any "management efforts" by anyone for two simple and obvious reasons:

- (1) the resale price will be a "market price" dependent upon supply and demand and the availability of willing buyers and
- (2) it is patently impossible to "manage" a carload of cotton bales or a warehouse full of tobacco or fifty tons of sugar

as part of a "common enterprise" run by some third-party "management" in the same sense that the operator of an orange grove runs his agricultural business, the owner of a mink or beaver ranch runs his animal business, the owner of a beef cattle ranch runs his cattle business, or the Shell Oil Company runs its oil and gas business.

By the same token, the value three or four years after purchase of a \$3,000 investment in, say, ten specific casks of Scotch whisky in bonded storage will depend upon what the "market" is for that commodity at the time of resale by the buyer. There is simply "no way" that those barrels of whisky could be "managed" as part of a "common enterprise" by anyone during that three or four year period. And there is, likewise, "no way" that the value of the whisky or the profit (or loss) made by the buyer could sensibly be said to depend or to be a function "solely" of business management efforts put forth by some third party during the time the buyer owned his casks of whisky.

We are totally unable to comprehend why the huge legal staff of the SEC, with its dozens and dozens of attorneys in Washington and throughout the country in various regional offices, cannot understand those simple facts and factual distinctions. It may be that they simply do not want to understand this situation because there has been a policy decision made somewhere that the Commission wants to regulate the Scotch

whisky commodity business no matter what Congress did with Section 2(1) and no matter what the Supreme Court held in the Howey case. That appears to be the case.

As the opinion by Circuit Judge Lumbard in the Brigadoon case, supra, indicates, the foregoing arguments were presented to a panel of the Second Circuit by counsel for the Milbank defendants in this case, although the court did not decide the issue under Section 2(1) in its opinion. It is significant, however, and worth pointing out to this court that, during oral argument and in the course of rebuttal argument by Walter P. North, Acting General Counsel for the Commission, after counsel for Brigadoon and Milbank had presented their case, Chief Judge Friendly stopped Mr. North in mid-sentence and said: "Let's face facts, Mr. North. The plain truth is that, prima facie, these things are not securities." Of course the Second Circuit reserved decision immediately thereafter, and the court declined to reach that issue in its opinion. And then Chief Judge Friendly may have changed his mind on the subject after leaving the bench that day. But the fact is that all three judges on that Circuit Court panel had read the briefs carefully before the oral argument, and they questioned counsel for both sides intently on the "security" versus "commodity" question. And we submit that Chief Judge (now former Chief Judge) Friendly had given some serious thought to the matter before he made in open court the statement quoted above. We simply present the facts in that connection to this

court for whatever it may wish to make of them, if anything.

In light of the facts described above, we submit that Judge Lumbard was writing most carefully and seriously after consultation with Judges Friendly and Thomsen and after circulation of a draft of his opinion to them for comment (as is the practice in the Second Circuit) when he wrote in his opinion in Brigadoon that:

"Appellants raise serious questions about whether their activities are subject to regulation by the SEC. Should the Commission seek to exercise regulatory control over appellants' business affairs at some future date, whether by means of a section 5 injunctive suit or otherwise, appellants will be entitled to a full hearing on their contentions."

Those words are preceded in Judge Lumbard's opinion by a lengthy summary in the court's words of what it considered those "serious questions" to be and what it understood the arguments of Brigadoon and Milbank to be with respect to them.

In the circumstances, it would seem to be an understatement to say that the Second Circuit has a completely open mind at present concerning the answers that should be given by that or any other federal court to those "serious questions." It is perfectly evident, however, that the SEC has grossly overstated its case in its briefs and arguments to this court when it states flatly and categorically that the law is "perfectly clear" on those questions left undecided by the Second Circuit in Brigadoon and there is absolutely no

room even for the slimmest judicial doubt as to whether or not the things which the defendants in this action sell or have sold in the past are a "security" which the SEC has authority to regulate under Sections 2(1) and 20(b) of the Securities Act or a "commodity" which they have no such authority to regulate and sales of which are, simply none of the Commission's con-founded business.

Defendants most respectfully submit that, when the controlling statutes and Supreme Court decisions are carefully examined, it becomes fairly clear that commencement of this action by the Commission was neither well-advised, nor authorized as a matter of law by Section 20(b) of the Securities Act, but represents, instead, a plain and unfortunate case of officious and unwarranted meddling by the SEC and its staff in the business affairs of defendants whose activities the Commission has no mandate or authority to regulate. In short, the SEC should be ordered by this court to leave these defendants and others engaged in similar businesses strictly alone and to cease harassing them with subpoenas for documents and subpoenas for testimony and telephone calls to salesmen and customers and banks who do business with them. As the Supreme Court stated in Oklahoma Press Pub. Co. v. Walling, 327 U.S. 186, 215-217 (1946): "Officious examination can be expensive, so much so that it eats up men's substance."

As counsel for the defendants has previously pointed

out to the court in an affidavit sworn to on September 17, 1973, this action is a direct descendant of a subpoena enforcement proceeding commenced by the SEC in the Southern District of New York against Milbank and certain other companies not named as defendants in this action. A decision by the district court in that case was appealed by both the SEC and the respondents, and the appeal was decided by the Second Circuit on June 7th of this year. S.E.C. v. Brigadoon Scotch Distributing Co., 480 F.2d 1047 (2d Cir., 6/7/73), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,017, reversing in part and affirming in part, F.Supp.

(S.D.N.Y., 1/10/73, Tenney, J.), CCH Fed.Sec.L.Rep., 72-73 Dec., ¶93,731.

The present action is also a relative of some kind to two other and similar suits commenced and won by the Commission in the District of Rhode Island and the Eastern District of Virginia: S.E.C. v. M.A. Lundy Associates, F. Supp. (D.R.I., 7/2/73, Day, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,040; S.E.C. v. Haffenden-Rimar International, Inc., F. Supp. (E.D. Va., 8/8/73, Lewis, J.), CCH Fed.Sec.L.Rep., Curr. Vol., ¶94,101.

How closely the facts of those cases compare to those involved in this case so far as the nature of the business practices engaged in by the defendants there and those in this action are concerned remains to be decided by this court on an appropriate record. From the brief reported opinions in those

cases and from the affidavits and exhibits served and filed by the SEC thus far in this action, it would appear that there are a great many glaring and substantial factual differences between the acts of the defendants complained of in those cases and the acts by the defendants alleged in the present action. We submit, however, that, in order for this court to make an informed decision in this case as to similarities and differences between the various business practices involved upon an appropriate record, it will be necessary for the court to conduct an evidentiary hearing on the jurisdictional facts of this case or the lack thereof.

The sketchy record provided by the self-serving and inference-laden affidavit filed by the SEC and its appended exhibits (consisting almost exclusively of "complaint letters" from unsatisfied customers) is almost totally inadmissible as evidence and therefore of very little, if any, evidentiary substance for purposes of the court's making findings of fact under Rule 52, F.R.C.P., as it must do if it were to grant the plaintiff's Rule 56 motion for partial summary judgment or its Rule 65 motion for a preliminary injunction calculated to put the defendants completely out of business and out of jobs pending final judgment in this action. An evidentiary hearing, preceded by appropriate discovery by the defendants and characterized by cross-examination of such witnesses as plaintiff may deem important enough to subpoena (including its "investigator,"

Mr. O'Connor, whose affidavit has been filed) would be the only sound way for this court to make the kind of solid record that would be necessary (1) before the facts of this case could be sufficiently clarified and determined for comparison with the facts found in the Lundy and Haffenden-Rimar cases and (2) before the drastic and potentially catastrophic relief which the SEC has requested in this action could reasonably and properly be granted by the court. S.E.C. v. Capital Gains Research Bureau, Inc., 300 F.2d 745, 746 (2d Cir. 1961), aff'd en banc, 306 F.2d 606 (2d Cir. 1962), rev'd on other grounds, 375 U.S. (1963); S.E.C. v. General Securities Company, 216 F. Supp. 350 (S.D.N.Y., 1963, Wyatt, J.); S.E.C. v. Frank, 388 F.2d 486, 490 (2d Cir. 1968); S.E.C. v. Great American Industries, Inc., 407 F.2d 453, 455 (2d Cir., en banc, 1968, opinion per Friendly, C.J.); 601 West 26 Corp. v. Solitron Devices, Inc., 291 F. Supp. 882 (S.D.N.Y., 1968, Herlands, J., ("Where the Court's jurisdiction is a substantial issue in controversy, a preliminary injunction should not issue."); S.E.C. v. Harwyn Industries Corp., 326 F. Supp. 943 (S.D.N.Y., 1971, Mansfield, J.). It is significant that neither in the opinion of Judge Day in the Lundy case, supra, nor in the opinion of Judge Lewis in Haffenden-Rimar, supra, does the court indicate any awareness of any of the authoritative opinions cited above in this paragraph. We do not believe that any of those cases were cited to the court in either of those cases. Whatever the controlling law may be in the First and Fourth Circuits, the Second Circuit has, we

submit, expressed itself quite clearly and forcefully on this point in the cases cited immediately above.

Moreover, neither in Lundy nor in Haffenden-Rimar does the opinion of the district court indicate any awareness by the court of the very significant statutory history of Section 2(1) of the Securities Act which the Second Circuit has set forth quite carefully in its opinion in Brigadoon and held to raise "serious questions about whether...[Milbank's] activities are subject to regulation by the SEC." Indeed, it would appear that neither Judge Day nor Judge Lewis was aware of the Second Circuit's decision in Brigadoon, despite the fact that Brigadoon was decided on 6/7/73, Lundy was decided on 7/2/73, and Haffenden-Rimar was decided on 8/8/73. Whatever the state of knowledge and learning was on the part of the respective district judges in Lundy and Haffenden-Rimar, there is no doubt about the fact that this court is in the Second Circuit, and the decision in Brigadoon has been brought carefully and vigorously to the attention of the court, together with the relevant legislative history of Section 2(1) and its relevance to the issues presented for determination on this motion by the defendants.

In both Lundy and Haffenden-Rimar, the courts placed primary and almost exclusive reliance upon the Supreme Court decisions in Howey, supra, and S.E.C. v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352-353 (1943). We have discussed the holding,

rationale and relevance of Howey above in this Point II.

Joiner Leasing involved an action by the SEC to enjoin, as violations of Sections 5 and 17 of the Securities Act, sales by the defendants of "assignments" of or interests in undeveloped "oil leases" which were broken down by the sellers into between 2.5 and 20 acre plots. In 1943, as now, Section 2(1) expressly included a reference to "fractional undivided interest[s] in oil, gas or other mineral rights." The defendants made, to the Supreme Court, the very narrow and obviously tenuous argument that what they sold were "divided" interests in oil rights and not "undivided interest[s]" within the meaning of the express reference to interests in oil rights included by Congress in Section 2(1). The Supreme Court simply rejected that argument as based upon too narrow a construction of the express language of Section 2(1) and held that, as a matter of both fact and law, what the defendants sold were "undivided interest[s]" in "oil, gas or other mineral rights" within the meaning of those words as enacted by Congress as part of Section 2(1).

It is obviously a very long step, indeed, from the very narrow holding of Joiner based upon specific words in Section 2(1) referring to sales of "oil...rights" to the very broad argument urged by the SEC in this action that the Commission has authority under Section 2(1) not merely to regulate the sale of "oil, gas and other mineral rights" (which constitute the only reference in Section 2(1) to sales of specific interests

in property and which were inserted in 1934 in substitution for broader language with reference to sales of interests in property in general, as discussed in Point I above) but has, also, the infinitely broader power under Section 2(1) to regulate sales of absolutely any kind of property at all (including oil paintings, as argued by counsel for plaintiff in this proceeding) where the buyer purchases for "investment" or as a "speculation" in reliance upon the "sales pitch" presented by the seller and upon the seller's purported "expertise" in the line of goods involved in the sale.

There are no clear-cut, objective limitations upon this potentially limitless regulatory jurisdiction claimed so brazenly by the SEC's staff. There are no statutes or administrative regulations designed to notify an honest businessman in advance of Commission action against him [by way of a subpoena for all of his business records (including banking information and customer lists) or a suit asking a federal court to put him out of business on three week's notice] of what kinds of things the SEC considers "securities" and what things are "commodities" not subject to regulation by the Commission. There is only Securities Act Release No. 5018 dated 11/4/69, which simply advises such a businessman that the SEC has no clear-cut policy or regulation as to when sales of interests in whisky will be deemed to involve sales of a "security" and the way he will learn whether or not his particular method of

doing business involves sales of "securities" (in the omniscient opinion of the SEC or its staff) will be after he has been (1) subpoenaed to surrender his books, records, banking relations and customer lists to be poured over and reproduced by the Commission's staff for its files, (2) then subpoenaed personally (along with all of his office employees and salesmen) to give testimony under oath to an SEC investigator, and (3) thereafter served with a summons, complaint and motion under Rule 65 calculated* to put him out of business and destroy everything he has worked for years to build up (on two weeks' notice.) *That is exactly what has happened to defendant Milbank in this case.

In other words, the only way a seller of title to Scotch whisky can learn whether or not his sales are subject to regulation by the SEC (according to the Commission's view of its own jurisdiction and authority) is (i) to subject himself to being investigated to death and driven to the wall by attorney's fees and then (ii) to wait and see whether or not the SEC decides to bring an injunction action or a criminal prosecution against him. We urge most vigorously that that is an absolutely disgraceful position for an agency of the United States Government to put a businessman in; that it violates every standard of equity, decency and fairness that one can imagine; and that it amounts to a palpable and outrageous violation by the Commission of well-established principles of due process of law. See, Connally v. General Construction Co.,

269 U.S. 385 (1926), and Lanzetta v. New Jersey, 306 U.S. 451 (1939).

We also submit that the phrase "any interest or investment commonly known as a 'security'" included in the definition of a "security" set forth in Section 2(1) contains precisely the same defect of incomprehensible vagueness as the state statute involved in Dombrowski v. Pfister, 380 U.S. 479 (1965), where the term "Communist Front Organization" was defined in a state "Subversive Activities and Communist Control Law" to include, inter alia, a "communist front organization." See: Brewer, "Dombrowski v. Pfister: Federal Injunctions Against State Prosecutions in Civil Rights Cases --- A New Trend in Federal-State Judicial Relations," 34 Fordham L. Rev. 71-106 (1965), at p. 75.

In Dombrowski, the Supreme Court held the state statute in question to be void-for-vagueness on its face because it defined the term "communist front organization" to include anything a state prosecutor might happen to consider a "communist front organization." Here Section 2(1) suffers the exact same defect of unreasonable vagueness, for it defines the term "security" to include anything "commonly known as a security," thereby using the term to define itself and authorizing the SEC or the Justice Department to prosecute or to bring an injunction action to destroy a substantial business without any reasonable, objective limits upon their discretion and whenever

they may happen to consider something to be "commonly known as a security." The phrase is clearly and totally vague, and its inclusion in the statute makes Section 2(1) unreasonably vague in the absence of some authoritative decision limiting it or of some reasonably clear regulation or ruling issued by the administrative agency involved, which we do not have in this case.

In short, the Commission's reliance upon Joiner Leasing as a controlling precedent in this case is entirely misplaced, and the unreasonably broad construction of Section 2(1) urged by the Commission staff upon this court must be completely rejected in favor of the more limited and sensible interpretation urged by counsel for the defendants in light of the legislative history of Section 2(1) and the most apposite Supreme Court cases interpreting that section, most notably the Howey case. To accept the SEC's broad and unrestricted interpretation of Section 2(1) would be (A) to give the Commission staff, by judicial interpretation, more jurisdiction than Congress intended it to have and (B) to render Section 2(1) unconstitutionally broad and vague, thereby making it unconstitutional and in violation of the due process clause of the Fifth Amendment as interpreted by this court.

CONCLUSION

For the reasons set forth above, each of the questions presented should be decided in favor of the appellants and instructions on remand to correct the errors below should be issued by this court as requested by the appellants.

Dated: New York, N. Y.
January 17, 1974

Respectfully submitted,

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Bradley R. Brewer, Of Counsel



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

DIVISION OF
TRADING AND MARKETS

July 6, 1967

Mr. Allan E. Backman
Executive Vice-President
National Better Business Bureau, Inc.
230 Park Avenue
New York, New York 10017

Re: Scotch Whisky Warehouse Receipts (HO-292)

Dear Mr. Backman:

I am very sorry for the delay in replying to your letter of May 10, 1967. It was unfortunately mislaid with some other material, and did not come to light until now.

Our position with respect to the necessity of registration under the Securities Act of 1933 by companies offering scotch whisky warehouse receipts is unchanged. As a consequence of that position, however, several companies (including Campbell, Eanderson & Co. Limited) have modified the terms of their offering. Under the present offers, the companies sell the whisky itself, rather than an investment contract based upon whisky. The purchaser owns the whisky, must insure it and warehouse it himself, and receives no investment advice from the sellers. Accordingly, no security is involved and no registration is required, as it was under the earlier types of investment. Our no-action position, of course, only applies to the particular facts on which it is based and not to all offers relating to investments in whisky. Therefore, some caution should still be exercised by prospective investors in scotch whisky to determine whether or not the offering is of the type which involves securities and thus requires registration with the Securities and Exchange Commission.

I hope that this letter will clarify the situation.

Very truly yours,

Arthur F. Mathews, Chief
Branch of Criminal Reference
And Special Proceedings

Peter J. Adolph

By: Peter J. Adolph
Attorney

EXHIBIT A

PROOF OF SERVICE

A true copy of the foregoing brief was served personally upon William D. Moran, Esq., counsel for the appellee by hand delivery to his representative on January 17, 1974.

Dated: New York, N. Y.

January 17, 1974

Bradley R. Brewer
Bradley R. Brewer
Attorney for the Appellants